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UNCLAS SECTION 01 OF 02 SHANGHAI 000458

SENSITIVE
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STATE FOR EAP/CM
TREASURY FOR AMBASSADOR HOLMER, WRIGHT AND TSMITH;
TREASURY FOR OASIA/INA - DOHNER, HAARSAGER/WINSHIP;
TREASURY FOR CUSHMAN
TREASURY FOR IMPF SOBEL. MOGHTADER
STATE PASS FEDERAL RESERVE BOARD FOR JOHNSON/SCHINDLER;
SF FRB FOR CURRAN/GLICK/LUNG; NY FRB FOR
CLARK/CRYSTAL/MOSELY/DAGES/DAWSON
NSC FOR WILDER AND LOI
STATE PASS CEA FOR BLOCK
STATE PASS USTR FOR STRATFORD/WINTER/MCCARTIN/KATZ
STATE PASS CFTC FOR OIA/GORLICK

E.O. 12958: N/A

TAGS: CH ECON EFIN

SUBJECT: SHANGHAI OFFICIALS STRESS COOPERATION WITH U/S MCCORMICK

¶1. (SBU) Summary. Treasury U/S McCormick and delegation met Shanghai Vice Mayor Tu Guangshao and Bank of Communications Chairman Hu Huaihang on October 21 in Shanghai. Both contacts emphasized that China is focused on assuring stable domestic economic growth during the fallout of the global financial crisis, and that this is not only good for China, but good for the United States and good for the world economy. Accompanying Vice Mayor Tu were Dr. Fang Xinghai of the Shanghai Financial Services Office and Mr. Tian Chunhua of the Shanghai Finance Bureau. U/S McCormick's delegation included Finatt Loewinger and Shanghai CG Camp, among others. End summary.

McCormick: U.S. Responding to Financial Crisis

¶2. (SBU) U/S McCormick outlined for his counterparts four sets of initiatives the U.S. Government has taken in recent weeks. In response to these initiatives, said McCormick, the financial markets have stabilized, although equity markets continue to be volatile:

-- The Federal Reserve has injected much liquidity into market and has followed up with measures to stimulate the commercial paper market.

-- The SEC is addressing market manipulation concerns.

-- The FDIC has implemented additional guarantees for the banking system, which should allay depositor concerns and unlock the interbank lending market.

-- The U.S. banking sector is being recapitalized.

¶3. (SBU) It is not clear that Chinese investors and institutions understand these constructive actions already taken, said U/S McCormick. The U.S. actions should improve credit markets and have prevented financial meltdown. Measures of recent days have also reduced counterparty risk, so Chinese banks' interbank lending to foreign banks should be less risky than they feared earlier.

¶ 14. (SBU) McCormick noted that on the one hand, Chinese authorities are well engaged, and have acted responsibly. However, actions that are rational and prudent by individual Chinese institutions and investors in sum can unsettle markets and send a message very different from the one of support and cooperation that the Chinese leadership wants to send, said McCormick. Examples of these actions include: money market mutual fund withdrawals, pulling back in lending of Treasury securities in the US market and lending of RMB to foreign banks in the Chinese market due to concerns about counterparty exposure, and shifting to shorter maturities for holdings of debt issued and guaranteed by Fannie and Freddie.

Vice Mayor Tu: China Wants Stable Economic Growth

¶ 15. (SBU) The Chinese Government sees that recovery of stability in U.S. financial markets is important for the whole world, including for China, said Tu. China will cooperate with the United States and do its own job to assure financial stability in China. Helping the U.S. financial markets is one of the means of assuring financial stability in Shanghai. China is the biggest investor in the U.S. financial markets, and the relationship between the U.S. financial markets and the Chinese economy is large. China hopes that U.S. measures will take effect quickly.

¶ 16. (SBU) Tu said China and Shanghai are encouraging Shanghai banks to lend to foreign banks -- this is important to Shanghai's own financial stability. China will seek financial market stability in the Shanghai stock market as well. Some

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Shanghai banks encountered minor liquidity problems with foreign counterparties, so these banks understandably paid more attention to risks, said Tu.

¶ 17. (SBU) While China recognizes the need to increase Chinese domestic consumption, this is a difficult task, said Tu. Much of China's economic growth has been linked to exports, but economies in many destination markets for China's exports are now slowing.

BoCom Chairman Praises U.S. Actions

¶ 18. (SBU) Bank of Commerce (BoCom) Chairman Hu Huaibang's remarks at his meeting with U/S McCormick had a similar tone -- that stabilizing China's economic growth will help support the U.S. economy. Key points:

-- Hu said he and his colleagues have the impression that "we are on the correct track," especially when the United States and other governments are coordinating their actions.

-- BoCom is positive on long-term U.S. growth prospects -- that is why BoCom wants to open a branch in San Francisco.

-- As an example of how Chinese banks are playing an important role in stabilizing the global market, Hu said that China Investment Corporation (CIC) not only maintained its stake in Morgan Stanley during that financial institution's troubles, but had been considering increasing its stake. Hu transferred from CIC, where he was chief supervisor, to BoCom in September, he said.

Bio Note

¶ 19. (SBU) Tu served as Vice Chairman of the China Securities Regulatory Commission prior to his selection as a Shanghai Vice Mayor in December 2007. His portfolio includes banking and personnel, and assisting in financial administration, taxation and auditing. Tu speaks fluent, although accented, English, and at times appeared to misunderstand technical financial terms used by U/S McCormick. Tu seemed eager to engage on a personal level, at one point joking with McCormick that a picture

accompanying a McCormick interview published in a Chinese newspaper was too serious. Tu has a booming laugh that he deployed several times during the half-hour meeting.

¶10. (U) Beijing Financial Attaché David Loevinger has cleared on this cable.

CAMP